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Washington, DC 202219  
**Docket ID OCC-2018-0026**  
**RIN 1557-AE48**

Ms. Ann E. Misback, Secretary  
Board of Governors  
Federal Reserve System  
20<sup>th</sup> Street & Constitution Ave. NW  
Washington, DC 20551  
**Docket No. R-1621**  
**RIN 7100-AF-15**

Robert E. Feldman, Executive Secretary  
Attn: Comments/Legal ESS  
Federal Deposit Insurance Corporation  
550 17<sup>th</sup> Street NW  
Washington, DC 20429  
**RIN 3064-AE90**

**RE: Regulatory Capital Treatment for High Volatility Commercial Real Estate Exposures**

To Whom It May Concern:

The Commercial Real Estate Finance Council (CREFC) appreciates this opportunity to comment on the Agencies' proposal (Proposal) to amend the regulatory capital rule to revise the definition of "high volatility commercial real estate (HVCRE) exposure" to conform to the statutory definition of "high volatility commercial real estate acquisition, development, or construction (HVCRE ADC)<sup>1</sup> loan," in accordance with section 214 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA).<sup>2</sup> We value the Agencies' efforts to implement the statutory language and the clarity provided during this transition period.

By way of background, CREFC's members represent U.S. commercial and multifamily real estate originators, issuers, investors, and service providers – a market valued at an estimated \$6.3

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<sup>1</sup> The statute or EGRRCPA refers to the exposures as "HVCRE ADC" while the proposed regulations and previous regulations use the acronym HVCRE. For simplicity, we generally will use "HVCRE" when referring to ADC exposures that qualify for a heightened risk weight.

<sup>2</sup> Office of the Comptroller of the Currency, Treasury; the Board of Governors of the Federal Reserve System; and the Federal Deposit Insurance Corporation, Notice of Proposed Rulemaking, Regulatory Capital Treatment for High Volatility Commercial Real Estate Exposures, 83 Fed. Reg. 48,990 (Sep. 28, 2018).

trillion supported by \$4.2 trillion of commercial real estate (CRE) debt.<sup>3</sup> We are also the only commercial real estate trade association that focuses exclusively on finance. Member firms include balance-sheet lenders (banks, insurance companies, publicly-traded commercial mortgage REITs, and non-bank private lending platforms) and securitized lenders, loan and bond investors, private equity firms, servicers and rating agencies, among others. Most notably for the topic of HVCRE and the contents of this letter, our members include both Standardized Approach and Advanced Approaches banks, as well as non-bank lenders who finance acquisition, development, and construction (ADC) loans.

In general, CREFC promotes capital formation, encouraging commercial real estate finance market efficiency, transparency and liquidity. CREFC also acts as a legislative and regulatory advocate for the industry, plays a vital role in setting market standards, and provides education for market participants in this key sector of the global economy.

## EXECUTIVE SUMMARY

Below, we provide specific responses to the Proposal and recommendations to continue to improve the HVCRE framework. Our comments focus on clarity and simplification, while also advancing the ultimate purpose of the risk-weight system – to align risk-taking with adequate risk capital. Additionally, we believe the recommendations promote prudent lending practices. Broadly, we categorize our substantive recommendations into two main areas: (1) the scope and definition of HVCRE loans, and (2) the exclusions from the HVCRE framework. We also address the Agencies’ question on whether reevaluation of existing loans is necessary and the status of existing guidance.

### Scope and Definition

The statute and the Proposal define HVCRE as “a credit facility secured by land or improved real property” as limited by a primarily-finances test, an income-producing purpose test, and a repayment test. Generally, we support the Agencies’ efforts to align their Proposal, to the extent possible, with existing bank reporting and regulations.

- (1) **Credit Facility Secured by Land or Improved Real Property:** To the extent it is consistent with the statute, we support using the Call Report instruction definition for “loan secured by real estate” to interpret “credit facility secured by land or improved real property.” The use of the Call Report definition is a positive step toward aligning various bank regulatory requirements.

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<sup>3</sup> Federal Reserve, Flow of Funds. <https://www.federalreserve.gov/releases/z1/current/default.htm> as of June 30, 2018

## Exclusions

The statute and Proposal further clarify the original HVCRE exclusions and add additional exclusions related to existing income-producing real property. We generally support the Agencies' proposed interpretations related to lot development loans, community development investments, and the use of "as is" appraisals for certain projects in the contributed capital exclusion.

We recommend, however, that the Agencies revise their interpretation of "1-4 family residential" to align with the Call Report instructions. Additionally, for purposes of the contributed capital exclusion related to multiphase projects, we are concerned the proposed interpretation could create inadvertent confusion with respect to credit facilities financing an entire project with multiple phases. We suggest the Agencies clarify that multiple appraisals are optional—but not required—on a credit facility that finances the entire project when the project is multiphase. Our comments on the exclusions are listed below.

- (2) **1-4 Family Residential Definition:** We recommend the Agencies also use the Call Report definitions for 1-4 family residential and construction rather than the proposed Interagency Real Estate Lending Standards. In either case, the interpretation should be consistent with the statute.
- (3) **Lot Development Loans:** We support the Agencies' proposed treatment of lot development loans as exempt via the 1-4 family residential exclusion.
- (4) **Investment in Community Development Exclusion:** We support the community development investment definition being tied to the Community Reinvestment Act regulations.
- (5) **Contributed Capital "As is" Appraisal:** We support the Proposal's use of an "as is" appraisal when an "as completed" value is not determinable.
- (6) **Multiphase Project Treatment:** We are concerned that the Agencies' interpretation of "project" may create confusion. The term "project" should not be read to require an appraisal on each phase of an entire multiphase project. The Agencies should clarify the treatment of a project as multiphase (in this context) is optional.

## Additional Comments

Beyond the substantive points of the Proposal, we appreciate the Agencies' efforts to provide flexibility and guidance during this transition period. To that end, we recommend that banking organizations be allowed—but not required—to reevaluate legacy HVCRE loans under the new

statute and regulations. As to guidance, we also suggest the existing HVCRE Frequently Asked Questions (FAQs)<sup>4</sup> be withdrawn.

- (7) **Reevaluation of Legacy Loans:** We recommend that banking organizations be allowed to reevaluate ADC loans originated after January 1, 2015, for compliance with the new HVCRE regulations, but in no case should a reevaluation be required.
- (8) **Withdraw Existing HVCRE FAQs:** As the statute and proposed new rule supersede the previous HVCRE language, we believe that the existing HVCRE FAQs are no longer valid. These FAQs should be moved to inactive status.

A more detailed discussion of each of the above recommendations follows:

## **I. Specific Comments on HVCRE Scope and Definition**

On May 24, 2018, the President signed EGRRCPA, which included a section that sought to simplify, clarify, and revise the HVCRE definition and exclusions under the Agencies' regulatory capital rules. We appreciate that the Proposal largely mirrors the statutory text and applaud the Agencies' efforts to streamline certain definitions. Overall, we recommend that any additional regulations or guidance on the scope and definitions of HVCRE adhere to principles of simplicity and clarity that underpin the statute.

As enumerated in the statute and Proposal, the HVCRE designation can only apply if an exposure is "a credit facility secured by land or improved real property" subject to three additional criteria.<sup>5</sup> As detailed below, we support the use of the Call Report instructions for interpreting "credit facility secured by land or improved real property."

- A. **Credit Facility Secured By Land Or Improved Real Property:** To the extent it is consistent with the statute, we support using the Call Report instruction definition for "loan secured by real estate" to interpret "credit facility secured by land or improved real property." The use of the Call Report definition is a positive step toward aligning various bank regulatory requirements.

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<sup>4</sup>Office of the Comptroller of the Currency, Treasury; the Board of Governors of the Federal Reserve System; and the Federal Deposit Insurance Corporation, Regulatory Capital: Frequently Asked Questions High Volatility Commercial Real Estate (HVCRE) Exposures (2015). <https://www.fdic.gov/regulations/capital/capital/faq-hvcre.pdf>

<sup>5</sup> We recognize that all three of these criteria must be present in a credit facility for the loan to be subject to the HVCRE risk-weight, but our comments focus on the threshold question. These are additional criteria are listed below:

- 1. Primarily finances, has financed, or refinances the acquisition, development, or construction of real property;
- 2. Has the purpose of providing financing to acquire, develop, or improve such real property into income-producing real property; and
- 3. Is dependent upon future income or sales proceeds from, or refinancing of, such real property for the repayment of such credit facility. 12 U.S.C. § 1831bb.

As a threshold requirement, Section 214 of EGRRCPA requires that HVCRE loans “be secured by land or improved real property.”<sup>6</sup> The Agencies are proposing to interpret “a credit facility secured by land or improved real property” consistent with the Call Report instructions definition of “loan secured by real estate.” We support this interpretation to the extent it aligns with the statutory requirements in EGRRCPA.

The Call Report instructions examine characteristics of the loan and the lien to determine whether it is “wholly or substantially secured by a lien or liens on real property....” A bright-line value test at origination determines a loan’s inclusion. In order to be wholly or substantially secured, “the estimated value of the real estate collateral at origination [less senior liens held by others] must be greater than 50 percent of the principal amount of the loan at origination.”<sup>7</sup>

The Agencies’ proposed use of the Call Report definition is an effective alignment of existing terminology already used by banking organizations. The Call Report “loan secured by real estate” definition is detailed, clear, and simplifies compliance by allowing banks to continue to leverage their existing reporting systems to categorize HVCRE loans.

## **II. Specific Comments on HVCRE Exclusions**

First and foremost, any risk-weight regime should be properly calibrated to assess a capital surcharge only on riskier credit facilities, while avoiding any undue burdens or costs on prudent lending practices or system liquidity. Accordingly, the scope of any risk-weighted exposure category must be carefully and clearly defined, and any exclusions must be appropriately designed to incentivize prudent and safe systematic lending and/or socially beneficial practices, e.g., lending for affordable housing projects. Our comments below address the scope of these exclusions.

- A. **1-4 Family Residential Definition:** We recommend the Agencies use the Call Report definitions for 1-4 family residential properties and 1-4 family residential construction loans rather than the proposed Interagency Real Estate Lending Standards.

While our members appreciate the Agencies’ efforts to align the proposed HVCRE interpretations with existing regulatory definitions, we recommend that the 1-4 family residential definition instead align with the Call Report. Since the Agencies are already proposing to use the Call Report instructions definition of “loan secured by real estate,” further aligning HVCRE definitions with the Call Report will simplify and streamline the rule with existing bank reporting and compliance systems.

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<sup>6</sup> “HVCRE ADC Loan is defined for the purposes of section 51 and with respect to a depository institution, as a credit facility secured by land or improved real property....” 12 U.S.C. § 1831bb.

<sup>7</sup> FFIEC 031 and 041 A-58.

Notably, the Call Report instructions incorporate the Agencies' proposed interpretation that lot development loans for 1-4 family residential are excluded.<sup>8</sup> However, since the Interagency Real Estate Lending Standard definition does not cover lot development loans, this inconsistency could create confusion with the Agencies' Proposal specifically to exclude lot development loans from HVCRE coverage.

The Proposal notes the Agencies considered using the Call Report instructions but characterized the two Call Report definitions—one for permanent loans and one for construction loans—as “distinct” and for “different reporting purposes.”<sup>9</sup> However, this characterization overlooks the fact that the “1-4 family residential construction loans” definition references and incorporates the definition of “1-4 family residential properties” as it is defined elsewhere in the Call Report instructions.<sup>10</sup> Thus, interpreting the HVCRE 1-4 family residential exclusion in line with the Call Report instructions definitions for “1-4 family residential properties” and “1-4 family residential construction loans” more closely tracks the language of the statute which exempts “a credit facility financing—(A) the acquisition, development, or construction of properties that are—(i) one-to four-family residential properties.”<sup>11</sup>

To the extent it aligns with the statute, we recommend the Agencies continue to leverage the Call Report instructions to interpret the 1-4 family residential exclusion.

**B. Lot Development Loans: We support the Agencies' proposed treatment of lot development loans as exempt via the 1-4 family residential property exclusion.**

Our members support excluding lot development loans from HVCRE status via in the 1-4 family residential properties exclusion. As noted above, the Agencies should interpret the entire 1-4 family residential property exclusion consistent with the Call Report instructions for additional clarity.

**C. Community Development Investment Exclusion: We support the Agencies' proposed community development investment exemption definition being tied to the Community Reinvestment Act regulations.**

We support the Agencies' proposal to align the “investment in community development” exclusion with the Community Reinvestment Act and its regulations. Again, we applaud the effort to incorporate existing regulatory definitions and practices into the HVCRE regime, which

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<sup>8</sup> “Construction loans to developers secured by tracts of land on which 1-4 family residential properties, including townhouses, are being constructed. ... Construction loans secured by individual parcels of land on which single 1-4 family residential properties are being constructed.” FFIEC 031 and 041 Schedule RC-C, Part I, Item 1.a(1).

<sup>9</sup> 83 Fed. Reg. at 48,993.

<sup>10</sup> “...i.e. loans for the purpose of constructing 1-4 family residential properties, which will secure the loan. The term ‘1-4 family residential properties’ is defined in Schedule RC-C, part I, Item 1.c below.” FFIEC 031 and 041 Schedule RC-C, Part I, Item 1.a(1).

<sup>11</sup> 12 U.S.C. § 1831bb.

will contribute to the rule's clarity. As the Agencies note, certain SBA 504 now may qualify as investments in community development in addition to other socially beneficial lending.<sup>12</sup>

**D. Contributed Capital “As is” Appraisal:** We support the Agencies’ proposed use of an “as is” appraisal alternative when an “as completed” value is not determinable.

The revised contributed capital exclusion in the EGRRCPA statute allows certain projects to be exempt from HVCRE if requirements related to the loan-to-value ratio and borrower capital contribution are met.<sup>13</sup> Specifically, the borrower capital contribution threshold is measured “at least 15 percent of the real property’s appraised, ‘as completed’ value.” As discussed in the Agencies’ proposal, an “as completed” value may not be available for certain types of exposures.<sup>14</sup> In these cases, we support the Agencies’ proposed use of an “as is” appraisal alternative when an “as completed” value is not determinable.

**E. Multiphase Project Treatment:** We are concerned that the Agencies’ interpretation of “project” may create confusion. The term “project” should not be read to require an appraisal on each phase of an entire multiphase project. The Agencies should clarify the treatment of a project as multiphase (in this context) is optional.

For the first time in an HVCRE rulemaking, the Agencies are proposing interpretive language on the term “project” as it is used for purposes of qualifying for the contributed capital exclusion.<sup>15</sup> Specifically, the discussion implies that a loan financing a phase or stage of a multiphase project would require an appraised value for each phase in order to qualify for the exclusion.

We are concerned that the Agencies’ interpretation of “project” may cause confusion with respect to multiphase projects in certain circumstances. “Project, for purposes of this exclusion,” should not be read generally to require an appraisal on each phase of a multiphase project, which could be unworkable, particularly when a credit facility finances an entire multiphase project. The Agencies should clarify the piecemeal treatment is optional.

When the credit facility is for the entire project, it could be overly complex or even unworkable to appraise each phase particularly since not all phases can be viewed or easily valued as

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<sup>12</sup> Community Reinvestment Act Regulations, 12 C.F.R. 25.12(g)(3).

<sup>13</sup> “(D) commercial real property projects in which—(i) the loan-to-value ratio is less than or equal to the applicable maximum supervisory loan-to-value ratio as determined by the appropriate Federal banking agency; (ii) the borrower has contributed capital of at least 15 percent of the real property’s appraised, ‘as completed’ value to the project [...]; and (iii) the borrower contributed the minimum amount of capital described under clause (ii) before the depository institution advances funds (other than the advance of a nominal sum made in order to secure the depository institution’s lien against the real property) under the credit facility, and such minimum amount of capital contributed by the borrower is contractually required to remain in the project until the credit facility has been reclassified by the depository institution as a non-HVCRE ADC loan under subsection.” 12 U.S.C. § 1831bb.

<sup>14</sup> 83 Fed. Reg. at 48,995.

<sup>15</sup> 83 Fed. Reg. at 48,995.

“projects,” and requiring multiple appraisals on a single project could be redundant. Further, this interpretation and potentially unintended requirement would interfere with a prudent industry practice of obtaining liens on total project land at origination and facilitating future subdivision and collateral releases on completed phases.

Our understanding is that proposed interpretation of “project” is designed to provide flexibility and not to burden lenders financing an entire project with multiple phases. In some cases, this interpretation would allow a lender to use the 15 percent contributed capital exclusion for a phase of an entire project. Our members support this flexibility.

However, banking organizations should be able to continue to use the contributed capital exemption for a loan on an entire project, even if it is multiphase, so long as there is an “as completed” appraisal for the entire project. The Agencies should clarify the piecemeal treatment is optional. Otherwise, the interpretation should be removed.

### **III. Additional Comments**

#### **A. Reevaluation of Legacy Loans: We recommend that banking organizations be allowed to reevaluate ADC loans originated after January 1, 2015, for compliance with the new HVCRE statute and rule, but in no case should the Agencies require reevaluation.**

EGRRCPA explicitly exempts ADC loans made prior to January 1, 2015, from a heightened risk-weight via a designation as an HVCRE ADC loan. For loans made after that date, the Agencies’ interagency statement published on July 6, 2018<sup>16</sup>, and the Proposal both would allow banking organizations to apply best efforts in either applying the statutory HVCRE ADC definition or the previous HVCRE definition.

CREFC members appreciate the flexibility in the transition period while the Agencies finalize the Proposal and recommend continuing this approach. In no case should the Agencies require a banking organization to reevaluate ADC loans made on or before January 1, 2015, and before the final revised regulation is effective. While we submit that the statute allows banks to reevaluate existing ADC loans and reclassify them under the new HVCRE definitions, the reevaluation should be optional and not mandatory, as a mandatory review would impose a higher maintenance of effort than was originally priced into the transactions.

Optional reevaluation is consistent with prudent risk taking and avoiding undue regulatory burden. The statutory changes to the HVCRE definitions and exemptions would likely only lower the risk-weights on existing ADC loan exposures and, thus, maintaining existing HVCRE designations is arguably a more conservative approach. Simply put, the Agencies should not

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<sup>16</sup> Board, FDIC, and OCC, Interagency statement regarding the impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA) (July 2018),



require a bank to spend more or incur additional out-of-pocket cost to pursue a lower capital charge on a handful of loans. Allowing banks a choice on whether to reevaluate ADC loans preserves flexibility and allows individual banking organizations to determine if they prefer to hold excess capital on these legacy loans.

**B. Withdraw Existing HVCRE FAQs:** We recommend the Agencies withdraw the existing HVCRE FAQs.

As the statute and proposed rule supersede the previous HVCRE language, we believe that the existing HVCRE FAQs<sup>17</sup> are no longer valid. These FAQs should be moved to inactive status.

#### **IV. Conclusion**

In summary, CREFC appreciates the Agencies' efforts to implement and interpret Section 214 of EGRRCPA. Our comments are restated below:

- 1) Support using the Call Report instruction definition for “loan secured by real estate” to interpret “credit facility secured by land or improved real property”;
- 2) Recommend using the Call Report definitions for 1-4 family residential and construction for the 1-4 family residential exclusion;
- 3) Support the treatment of lot development loans as exempt via the 1-4 family residential property exclusion;
- 4) Support the proposed community development investment exclusion interpretation;
- 5) Support the use of an “as is” appraisal when an “as completed” value is not determinable;
- 6) Urge the Agencies to avoid unintended consequences and clarify that the term “project” should not be read to require an appraisal on each phase of an entire multiphase project;
- 7) Recommend that banking organizations have the option to reevaluate legacy ADC loans originated for compliance with the new HVCRE regulations; and
- 8) Recommend withdrawing the HVCRE FAQs.

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<sup>17</sup> HVCRE Frequently Asked Questions (2015) <https://www.fdic.gov/regulations/capital/capital/fag-hvcre.pdf>

We look forward to working with the Agencies on implementing the new HVCRE framework to make the structure more workable and less costly for all banks subject to the capital rule and to properly align risk-taking with adequate risk capital.

Thank you for your consideration.

Sincerely,

A handwritten signature in dark ink, reading "Lisa A. Pendergast". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

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